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PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

Chapter IV. THE PROJECT AGREEMENT

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LEGISLATIVE RECOMMENDATIONS

Conclusion of the project agreement (see paras. 5-8)

(1) The host country may wish to adopt provisions that simplify the procedures for the conclusion of the project agreement and identify in advance the offices or agencies competent to approve and sign the project agreement.

Financial arrangements (see paras.10-21)

(2) The host country may wish to provide:

(a) That any financing of the infrastructure facility may be in such amounts and upon such terms and conditions as may be determined by the concessionaire and that, for that purpose, the concessionaire may in particular issue debt, equity and other securities or obligations, and secure any financing with a security interest in any of its property;

(b) That the project agreement should provide for tariffs or user fees that may be charged by the concessionaire for the use of the facility or the services it provides, and should set forth the method and formulae for the adjustment of those tariffs or user fees;

(c) That the project agreement should provide for tariffs or user fees that allow for the recovery of the capital invested and the operation and maintenance costs with a reasonable rate of return.

(3) The host country may further wish to provide:

(a) That the contracting authority is authorized, where appropriate, to agree to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users;

(b) That the contracting authority is authorized, where appropriate, to enter into commitments for the purchase of fixed sums of goods or services.

The project site (see paras. 22-27)

(4) The host country may wish to provide:

(a) That the project agreement should specify, as appropriate, which assets will remain the property of the contracting authority or of other governmental agencies and which categories of assets will remain the private property of the concessionaire;

(b) That the compulsory acquisition of any land required for privately financed infrastructure projects should be carried out pursuant to the most efficient proceedings available under the laws of the host country.

Easements (see paras. 28-31)

(5) The host country may wish to adopt legislative provisions that identify the easements that might be needed by the concessionaire.

Security interests (see paras. 32-40)

(6) The host country may wish to provide:

(a) That the concessionaire may create a security in respect of any of its property interests in the infrastructure facility;

(b) That the concessionaire may secure any financing with a pledge of the proceeds and receivables arising out of the concession.

Organization of the concessionaire (see paras. 41-51)

(7) The host country may wish to provide that the selected bidders should establish an independent legal entity with a seat in the country, except for cases where the contracting authority has waived such requirement.

(8) Where the selected bidders are required to establish an independent legal entity, the host country may wish to provide that the project agreement should specify:

(a) The form of the legal entity and its minimum capital;

(b) The procedures for obtaining the approval of the contracting authority to fundamental changes in the statutes and by-laws of the concessionaire company, which approval should not be unreasonably withheld.

Assignment of the concession (see paras. 52-55)

(9) The host country may wish to require that the project agreement set forth the conditions under which the contracting authority may give its consent to the assignment of a concession, including:

(a) Acceptance by the new concessionaire of all obligations under the project agreement;

(b) Evidence of the new concessionaire's technical and financial capability as necessary for providing the service.

Transferability of shares of the project company (see paras. 56-63)

(10) The host country may wish to provide that the transfer of equity participation in the capital of a concessionaire company may require the consent of the contracting authority if:

(a) The concessionaire is in the possession of public assets or assets which the concessionaire is required to hand over to the contracting authority at the end of the concession period; or

(b) The concessionaire has received or benefited from loans, subsidies, equity or other forms of direct financial support by the Government.

Duration of the project agreement (see paras. 64-67)

(11) The host country may wish to provide that all concessions should have a limited duration, which should be specified in the project agreement, taking into account the nature and amount of investment required to be made by the concessionaire.

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. General considerations

1. The "project agreement" between the Government and the concessionaire is the central document in an infrastructure project. The project agreement defines the scope and purpose of the project as well as the rights and obligations of the parties; it provides details on the execution of the project and sets forth the conditions for the operation of the infrastructure or the delivery of the relevant services. Project agreements may be contained in one single document or may consist of more than one separate agreement between the contracting authority and the concessionaire. This section discusses the relation between the project agreement and the host country's legislation on privately financed infrastructure projects. It also discusses procedures and formalities for the conclusion and entry into force of the project agreement.

1. Legislative approaches

2. The project agreement is the instrument through which the Government exercises its authority to entrust a concessionaire with the responsibility to carry out an infrastructure project (see chapter I, "General legislative considerations", ___). Therefore, there is an intrinsic link between the project agreement and the laws of the host country that govern the execution of privately financed infrastructure projects or, more generally, the provision of public services. Domestic legislation often contains provisions dealing with the content of the project agreement. In this respect, three main approaches have been used. While the laws of some countries merely refer to the need for an agreement between the concessionaire and the contracting authority, the laws of other countries contain extensive mandatory provisions concerning the content of clauses to be included in the agreement. An intermediate approach is taken by those laws that list a number of issues that need to be addressed in the project agreement without regulating in detail the content of its clauses.

3. Legislative provisions on certain essential elements of the project agreement may serve the purpose of establishing a general framework for the allocation of rights and obligations between the parties. They may be intended to ensure consistency in the treatment of certain contractual issues and to provide guidance to the public authorities involved in the negotiation of project agreements at different levels of Government (national, provincial or local). Such guidance may be found particularly useful by contracting authorities lacking experience in the negotiation of project agreements. Some countries may further consider that legislative provisions on certain elements of the project agreement may enhance the contracting authority's negotiating position vis-à-vis the concessionaire. Lastly, legislation may sometimes be required so as to provide the contracting authority with the power to agree on certain types of provisions.

4. The possible disadvantage of legislative provisions dealing in detail with the rights and obligations of the parties is that they might deprive the contracting authority and the concessionaire of the necessary flexibility to negotiate an agreement that takes into account the needs and particularities of a specific project. Therefore, it is advisable to limit the scope of legislative provisions concerning the project agreement to those strictly necessary, such as, for instance,

provisions on matters for which prior legislative authorization might be needed or those that might affect the interests of third parties or provisions relating to essential policy matters on which variation by agreement is not admitted.

2. Conclusion of the project agreement

5. For projects as complex as infrastructure projects, it is not unusual that several months elapse in negotiations before the parties are ready to sign the project agreement. A number of factors have been reported to cause delay in the negotiations, such as inexperience of the parties, poor coordination between different governmental agencies, uncertainty as to the extent of governmental support, or difficulties in establishing security arrangements acceptable to the lenders.1/ In order to avoid unnecessary delay in the conclusion of the project agreement, it is advisable to have rules in place that identify clearly the persons or offices that have the authority to enter into commitments on behalf of the contracting authority (and, as appropriate, of other agencies of the Government) at different stages of negotiation and to sign the project agreement. For projects involving offices or agencies at different levels of government (e.g. national, provincial or local), where it may not be possible to identify in advance all the relevant offices and agencies involved, other measures may be needed to ensure appropriate coordination among them (see chapter I, "General legislative considerations", ___).

6. Moreover, a significant contribution may be made by the Government by providing adequate guidance to negotiators acting on behalf of the contracting authority. The clearer the understanding of the parties as to the matters to be provided in the project agreement, the greater the chances that the negotiation of the project agreement will be conducted successfully. Conversely, where important issues remain open after the selection process and little guidance is provided to the negotiators as to the substance of the project agreement, there might be considerable risk of costly and protracted negotiations as well as of justified complaints that the selection process was not sufficiently transparent and competitive (see further chapter III, "Selection of the concessionaire", ___).

7. In addition to practical arrangements to facilitate the negotiation of the project agreement, it is important to consider measures to expedite its conclusion. Some national laws prescribe certain formalities for the conclusion and entry into force of project agreements. In some countries the terms of the agreement negotiated between the contracting authority and the selected bidders may be subject to approval by a higher authority. The entry into force of the project agreement or of certain categories of project agreements is in some countries subject to an act of parliament or even the adoption of special legislation.

8. With a view to expediting matters and avoiding the adverse consequences of delays in the project's timetable, in some countries the authority to bind the contracting authority or the

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1/ For a discussion of issues having an impact on achieving financial closure, see International Finance Corporation, *Financing Private Infrastructure*, Washington, D.C., 1996, p. 37.

Government, as appropriate, is delegated in the relevant legislation to designated officials, so that the entry into force of the project agreement occurs upon signature or upon the completion of certain formalities, such as publication in the official gazette. In countries where such a procedure might not be feasible, or in which final approvals by another entity would still be required, it would be desirable to consider ways to avoid unnecessary delay. It is important to bear in mind that the risk of the project being frustrated by lack of approval after negotiations have been completed is not one that the concessionaire would be ready to assume. Where approval requirements are perceived as arbitrary or cumbersome, the Government might be requested to provide sufficient guarantees to the concessionaire and the lenders against such risk (see chapter II, "Project risks and Government support", ___). In some countries where those approval requirements exist, Governments have sometimes agreed in the project agreement to compensate the concessionaire for all costs incurred in the event the final approval of a project is withheld for reasons not imputable to the concessionaire.

B. Core terms of the project agreement

9. Project agreements are typically lengthy documents that deal extensively with a wide variety of general and project-specific issues. This section discusses possible legislative implications of what in national laws appear to be core provisions of project agreements, i.e. those that define the essential financial obligations of the parties, the nature of the rights granted to the concessionaire, the project site and the ownership regime in respect of project assets, the organization of the concessionaire and the duration of the project.

1. Financial arrangements

10. The financial arrangements belong to the essential terms of the project agreement. They typically include provisions concerning the concessionaire's obligations for raising funds for the project, outline the mechanisms for disbursing and accounting for funds, set forth methods for calculating and adjusting the prices charged by the concessionaire and deal with the types of security interests that may be established in favour of the concessionaire's creditors. In drafting these provisions care needs to be taken to ensure their consistency with the loan agreements and other financial commitments entered into by the concessionaire. It is further important to ensure that the laws of the host country are conducive or do not pose obstacles to the financial management of the project.

(a) Financial obligations of the concessionaire

11. In privately financed infrastructure projects the concessionaire is typically responsible for raising sufficient financing for the project. In most cases, the contracting authority or other governmental agencies would be interested in limiting their financial obligations to those specifically expressed in the project agreement or those forms of direct support that the Government has agreed to extend to the project (see chapter II, "Project risks and Government support", ___).

12. The amount of private capital contributed directly by the project company's shareholders typically represents only a portion of the total proposed investment. A far greater portion derives from loans extended to the concessionaire by commercial banks and from the proceeds of the placement of bonds and other negotiable instruments on the capital market (see "Introduction and background information on privately financed infrastructure projects", ___). Therefore, it may be useful for the law to acknowledge the concessionaire's authority to enter into the financial arrangements it sees fit for the purpose of financing the infrastructure. It is further important to ensure that the laws of the host country will not unreasonably restrict the concessionaire's ability to conclude the necessary financing arrangements, for instance by limiting the concessionaire's ability to offer adequate security to its lenders (see paras. 32-40).

13. The revenue obtained with the placement of bonds and other negotiable instruments may represent a substantial source of financing for infrastructure projects. Those instruments may be issued by the concessionaire itself, in which case the investors purchasing the security will become its creditors, or they may be issued by a third party to whom the project receivables (see para. 39) have been assigned through a mechanism known as "securitization". Securitization involves the creation of financial securities backed by the project's revenue stream, which is pledged to pay the principal and interest of that security. Securitization transactions usually involve the establishment of a legal entity separate from the concessionaire and especially dedicated to the business of securitizing assets or receivables. This legal entity is often referred to as "special purpose vehicle". The concessionaire assigns project receivables to the special purpose vehicle, which, in turn, issues to investors interest-bearing instruments that are backed by the project receivables. The securitized bondholders acquire thereby the right to the proceeds of the concessionaire's transactions with its customers. The concessionaire collects the tariffs from the customers and transfers the funds to the special purpose vehicle which then transfers it to the securitized bondholders. In some countries, recent legislation has expressly recognized the concessionaire's authority to assign project receivables to a special purpose vehicle, who holds and manages the receivables in trust to the benefit of the project's creditors. With a view to protecting the bondholders against the risk of insolvency of the concessionaire, it may be advisable to adopt the necessary legislative measures to enable the legal separation between the concessionaire and the special purpose vehicle.

(b) The concessionaire's authority to charge prices for public services

14. In a number of countries prior legislative authorization may be necessary in order for a concessionaire to charge a price for the provision of public services or for the use of public infrastructure facilities. Therefore it is desirable that the law contain general provisions authorizing the contracting authority and the concessionaire to agree on the suitable form of payment for the concessionaire, including the right to charge a price for the use of the infrastructure or the service or goods it provides. The absence of such a general provision in legislation has in some countries given rise to judicial disputes challenging the concessionaire's authority to charge a price for the service.

15. In addition to a general recognition of the concessionaire's authority to charge a price for the provision of public services or for the use of public infrastructure facilities, it is important to

consider the level of tariffs and prices that the concessionaire may charge. Tariffs and prices charged by the concessionaire may be the main (sometimes even the sole) source of revenue to pay the investment made in the project in the absence of subsidies or payments by the contracting authority (see paras. 17-21) or the Government (see chapter II, "Project risks and Government support," ___). The concessionaire will therefore seek to be able to set and maintain those tariffs and prices at a level that ensures sufficient cash flow for the project. However, in some legal systems there may be limits to the concessionaire's freedom to establish tariffs and prices. The cost at which public services are provided is typically an element of the Government's infrastructure policy, and a matter of immediate concern for large portions of the public. Thus, the regulatory framework in many countries includes special rules to control tariffs and prices for the provision of public services (see chapter V, "Infrastructure development and operation", ___). Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that prices meet certain standards of "reasonableness", "fairness" or "equity".

16. Where provisions on the level of tariffs and prices that the concessionaire may charge are deemed necessary, they should seek to achieve a balance between the interests of investors and current and future users. It is advisable that statutory criteria for determining prices take into account, in addition to social factors which the Government regards as relevant, the concessionaire's interest in achieving a level of cash flow that ensures the economic viability and commercial profitability of the project. It may thus be useful for the law to acknowledge that the recovery of the capital and the operation and maintenance cost with a reasonable rate of return is one of the essential elements of a fair tariff system. Furthermore, it is advisable to provide the parties with the necessary authority to negotiate appropriate arrangements, including compensation provisions, in order to address situations where the application of price control rules directly or indirectly related to the provision of public services may result in fixing prices below the level required for the profitable operation of the project (see chapter V, "Infrastructure development and operation", ___).

(c) Financial obligations of the contracting authority

17. Where the concessionaire offers services directly to the general public, the contracting authority or other governmental agency may undertake to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users. Where the concessionaire produces a commodity for further transmission or distribution by another service provider, the contracting authority may undertake to purchase wholesale such commodity at an agreed price and conditions. The main examples of those arrangements are briefly discussed below.

(i) Direct payments

18. Direct payments by the contracting authority have been used in some countries as a substitute for, or as supplement to, payments by the end users, in particular in toll road projects, through a mechanism known as "shadow tolling". Shadow tolls are arrangements whereby the concessionaire assumes the obligation to develop, build, finance and operate a road or another transportation facility for a set number of years in exchange for periodic payments in place of, or in addition to, real or

explicit tolls paid by users. Shadow toll schemes may be used to address risks which are specific to transportation projects, in particular the risk of lower-than-expected traffic levels (see chapter II, "Project risks and Government support", ___). Furthermore, shadow toll schemes may be politically more acceptable than direct tolls, for example where it is feared that the introduction of toll payments on public roads may give rise to protests by road users.

19. Shadow tolls may involve a substantial expenditure for the contracting authority and require close and extensive monitoring by the contracting authority. In countries that have used shadow tolls for the development of new road projects, payments by the contracting authority to the concessionaire are based primarily on actual traffic levels, as measured in vehicle-kilometres. It is considered advisable to provide that payments are not made until traffic begins, so that the concessionaire has an incentive to open the road as quickly as possible. At the same time, it has been found useful to calculate payments on the basis of actual traffic for the duration of the concession, so that the concessionaire also has reason to ensure that the road will need a minimum of disruptive repairs during that time. Alternatively, the project agreement could contain a penalty or liquidated damages clause for lack of lane availability due to repair works calculated. Payment systems used in some countries are further refined by dividing traffic into a number of "bands", with different levels of annual traffic volumes and per-vehicle payments, whereby lower traffic levels entail higher per-vehicle payments, while higher traffic levels cause lower per-vehicle payments. The bands themselves may be increased over time to match anticipated growth in traffic. Separate bands may be established according to the length of the vehicles. The concessionaire is typically required to perform continuous traffic counts to calculate annual vehicle miles, which are verified periodically by the contracting authority. A somewhat modified system may combine both shadow tolls and direct tolls paid by the users. In such a system, shadow tolls are only paid by the contracting authority in the event that the traffic level over a certain period falls below the agreed minimum level necessary in order for the concessionaire to operate the road profitably.

(ii) Purchase commitments

20. In the case of privately financed facilities that generate goods or services that can be delivered on a long-term basis to an identified purchaser, the concessionaire's exposure to market demand and price risks may by mitigated by contractual arrangements that ensure the purchase of the whole output of the facility or of an agreed minimum portion thereof. When the contracting authority or another governmental entity is the sole customer for the services or goods supplied by the concessionaire, the law sometimes provides that those entities will be under an obligation to purchase such goods and services, at an agreed rate, as they are offered by the concessionaire. Contracts of this type are usually referred to as "off-take agreements" and are frequently, but not exclusively, used to support the development of power generation plants by independent power producers. Off-take agreements often include two types of payments: payments for the availability of the production capacity and payments for units of actual consumption. In a power generation project, for example, the power purchase agreement may contemplate the following charges:

(a) *Capacity charges*. These are charges payable regardless of actual output in a billing period and are calculated to be sufficient to pay all of the concessionaire's fixed costs incurred to

finance and maintain the project, including debt service and other ongoing financing expenses, fixed operation and maintenance expenses and a certain rate of return. The payment of capacity charges is often subject to the observance of certain performance or availability standards.

(b) *Consumption charges*. These charges are not intended to cover all of the concessionaire's fixed costs, but rather to pay the variable or marginal costs that the concessionaire has to bear to generate and deliver a given unit of the relevant service or good (e.g. a kilowatt-hour of electricity). Consumption charges usually are calculated to cover the concessionaire's variable operating costs, such as of fuel consumed when the facility is operating, water treatment expenses and costs of consumables. Variable payments often are tied to the concessionaire's own variable operating costs, or to an index that reasonably reflects changes in operating costs.

21. From the perspective of the concessionaire, a combined scheme of capacity and consumption charges is particularly useful to ensure cost recovery where the transmission or distribution function for the goods or services generated by the concessionaire is subject to a monopoly. However, the capacity charges provided in the off-take agreement should be commensurate with the other sources of generating capacity available to, or actually used by, the contracting authority. High capacity charges place a burden on the contracting authority's purchasing capacity and increase the risk of default or repudiation of the agreement, for instances on grounds of public interest. In order to ensure the availability of funds for payments by the contracting authority under the off-take agreement, it is advisable to consider whether advance budgeting arrangements are required. Payments under an off-take agreement may be backed by a guarantee issued by the host Government or by a national or international guarantee agency (see chapter II, "Project risks and Government support", __).

2. The project site

22. Where a new infrastructure facility is to be built on land owned by the contracting authority, or an existing infrastructure facility is to be modernized or rehabilitated (such as in "modernize-operate-transfer" or "rehabilitate-operate-transfer" projects), it will normally be for the contracting authority, as the owner of such land or facility, to make it available to the concessionaire. The contracting authority may either transfer to the concessionaire title to the land or facilities or retain title thereto, while granting the concessionaire a right to use the land or facilities and build upon it. In addition to the general legislative authority that may be required in order for the contracting authority to transfer public property to the concessionaire or to grant to the concessionaire the right to use such public property (see chapter I, "General legislative considerations", ___), it is important to consider the ownership regime of the various categories of assets that are required to the development and operation of infrastructure facilities, and the procedures for acquiring the property, where it is not already in the contracting authority's possession.

(a) Ownership of project assets

23. In some countries the law provides that the physical infrastructure required to the provision of public services remains the property of the contracting authority. However, during the life of the project the concessionaire may make extensive improvements or additions to the physical

infrastructure originally received from the contracting authority or built by the concessionaire itself. The concessionaire may also acquire various other assets which, without being indispensable or strictly necessary for the provision of the service, may enhance the convenience or efficiency of operating the facility or the quality of the service. In either situation there may be doubts about the ownership in respect of those assets. Clarity in this respect is needed in order to determine the type and extent of security interests that the concessionaire may establish over project assets in order to raise financing for the project (see paras. 34-36). Clarity will be further needed with a view to ensuring an orderly hand-over of assets to the contracting authority or to another concessionaire at the end of the project term in case of "build-operate-transfer" and similar types of projects (see chapter VI, "End of project term, extension and termination", ___). While the law may provide a general definition of categories of assets that should ordinarily remain the property of the contracting authority or of another governmental agency or that are mandatorily required to be handed over to the contracting authority, there may be no compelling need for detailed legislative provisions on this matter. In fact, in various countries it was found sufficient to require in the law that the project agreement specify, as appropriate, which assets will remain the property of the contracting authority or other governmental agency and which categories of assets will remain the private property of the concessionaire.

(c) Acquisition of land required for executing the project

24. Both in cases where the infrastructure facility will be transferred back to the contracting authority or will be permanently owned by the concessionaire, it is advisable that the parties establish the condition of such land and facility at the time it is handed over to the concessionaire. Such determination may reduce disagreements at the time the infrastructure facility is returned to the contracting authority. Therefore, the project agreement should provide for the inspection, measurement and demarcation of such land and existing facility prior to its being transferred or made available to the concessionaire. Further matters which would be typically dealt with in the project agreement include procedures for handing over the land or facilities and the submission of required documentation.

25. The situation may become more complex when the land is not already owned by the contracting authority and needs to be purchased from its owners. In most cases, the concessionaire would not be in the best position to assume the responsibility for purchasing the land needed for the project. The concessionaire may fear the potential delay and expense involved in negotiations with possibly a large number of individual owners and, as necessary in some parts of the world, to undertake complex searches of title deeds and review of chains of previous property transfers so as to establish the regularity of the title of individual owners. Therefore, it is typical for the contracting authority to assume the responsibility for providing the land required for the implementation of the project, so as to avoid unnecessary delay or increase in the project cost as a result of the acquisition of land. The contracting authority may purchase the required land from its owners or, if necessary, acquire it compulsorily. The procedure for the compulsory acquisition of private property against the payment of appropriate compensation to the owners, in accordance with the rules in force in the host country and relevant rules of international law, is referred to in domestic laws by various technical expressions. In the *Guide* it is referred to as "expropriation".

26. Where expropriation procedures are required, various preparatory measures may need to be taken to ensure that construction works are not delayed. In countries where the law contemplates more than one type of expropriation proceeding, it may be desirable to provide that all expropriations required for privately financed infrastructure projects be carried out pursuant to the most efficient of those proceedings, such as the special proceedings that in some countries apply for reasons of compelling public need (see chapter VII, "Governing law", ___).

27. The right to expropriate private property is usually vested in the Government, but the laws of a number of countries also authorize infrastructure operators or public service providers (e.g. railway companies, electricity authorities, telephone companies) to perform certain actions for the expropriation of private property required for providing or expanding their services to the public. Particularly in those countries where the award of compensation to the owners of the property expropriated is adjudicated in court proceedings, it has been found useful to delegate to the concessionaire the authority to carry out certain acts relating to the expropriation, while the Government remains responsible for accomplishing those acts that, under the relevant legislation, are conditions precedent to the initiation of expropriation proceedings. Upon expropriation, title to the land is often vested in the Government, although in some cases the law may authorize the contracting authority and the concessionaire to agree on a different arrangement, taking into account their respective shares in the cost of expropriating the property.

3. Easements

28. Besides the acquisition of property for the construction of the facility, there might be a need for ensuring the concessionaire's access to such property, in cases where the location of the site of the project is such that access to it requires transit on or through the property of third parties. The nature of the project may also be such that it requires the concessionaire to enter property belonging to third parties (e.g. to place traffic signs on adjacent lands; to install poles or electric transmission lines above third parties' property; to install and maintain transforming and switching equipment; to trim trees that interfere with telephonic lines placed on abutting property). The right to use another person's property for a specific purpose or to do work on it is generally referred to in the *Guide* by the word "easement".

29. Easements usually require the consent of the owner of the property to which they pertain, unless such rights are provided by the law. Except for cases where the required easements affect only a small number of adjacent properties, it is usually not an expeditious or cost-effective solution to leave it to the concessionaire to acquire easements directly from the owners of the properties concerned. Instead it is more frequent that those easements are acquired by the Government simultaneously with the expropriation of the project site. The compulsory acquisition of easements is usually subject to essentially the same conditions that apply to the compulsory acquisition of property, namely, the existence of grounds or reasons of public interest and the payment of appropriate compensation in accordance with the rules in force in the host country and relevant rules of international law.

30. A somewhat different alternative might be for the law itself to provide the types of easements given to the concessionaire, without necessarily requiring the expropriation of the property to which

such easements pertain. Such an approach might be used in respect of sector- where the Government deems it possible to determine, in advance, certain minim might be needed by the concessionaire. For instance, a law specific to the powe may lay down the conditions under which the concessionaire obtains a right of cabi of placing and operating basic and distribution networks on property belonging to a right may be needed for a number of measures, such as establishing or placin overhead cables, as well as establishing supporting structures and transform equipment; maintaining, repairing and removing any of those installations; establi along underground or overhead cables; removing obstacles along the wires or c safety zone.

31. Under some legal systems, the concessionaire might be under an obligation t to the owner, as would have been due in the case of expropriation, should the natu be such that the use of the property by its owner is substantially hindered.

4. Security interests

32. Generally, security interests in personal property provide the secured credi two kinds of rights: a property right allowing the secured creditor, in principle property or have a third party repossess and sell it, and a priority right to receive proceeds from the sale of the property in the event of default by the debtor. In practice, lenders negotiate security interests that allow them to foreclose and ta project which they can take over and operate either to restore its economical viabi reselling at an appropriate time or to retaining the project indefinitely and collect a r Furthermore, security may play a defensive or preventive role by ensuring that, i party acquires the debtor's operations (e.g. by foreclosure, in bankruptcy or directl all of the proceeds resulting from the sale of those assets will go first to repaym loans.

33. Security arrangements play a central role in financing infrastructure projects, the financing is structured under the "project finance" modality. The financing docu financed infrastructure projects typically include extensive security arrangements w comprise both security over physical assets related to the project and security ove held by the concessionaire. A few of the main requirements for the successful clos arrangements are discussed below.

(a) Security over physical assets

34. The negotiation of security arrangements required in order for the project financing for the project may be generally facilitated if the laws of the host country e the creation of security interests over the physical assets comprised in the infrastr there may be legal obstacles to the creation of such security interests, in particula remain in the property of the contracting authority or other governmental agency thro

term. If the concessionaire lacks the title to the property it will in many legal systems have no (or only limited) power to encumber such property.

35. Where limitations of this type exist, the law may still facilitate the negotiation of security arrangements for instance by indicating the types of assets in respect of which such security interests may be created or the type of security interests that is permissible. In some legal systems, a concessionaire who is granted a leasehold interest or right to use certain property may create a security interest over the leasehold interest or right to use. Furthermore, security interests may also be created where the concession encompasses different types of public property, such as when title to adjacent land (and not only the right to use it) is granted to a railway company in addition to the right to use the public infrastructure.

36. Where it is possible to create any form of security interests in respect of assets owned by, or required to be handed over to, the contracting authority, or assets in respect of which the contracting authority has a contractual option of purchase (see chapter VI, "End of project term, extension and termination", ___), the law may require the approval of the contracting authority in order for the concessionaire to create such security interests. With a view to facilitating the creation of security, in such a situation, it may be useful to authorize the contracting authority to express such approval by a general provision in the project agreement, rather than requiring specific acts of approval for each asset in respect of which a security interest is created.

(b) Security over intangible assets

37. The main intangible asset in an infrastructure project is the concession itself, i.e. the concessionaire's right to operate the infrastructure or provide the relevant service. In most legal systems, the concession provides its holder with the authority to control the entire project and entitles the concessionaire to earn the revenue generated by the project. Thus, the value of the concession well exceeds the combined value of all of the physical assets involved in a project. Because the concession holder would usually have the right to possess and dispose of all project assets (with the possible exception of those which are owned by other parties, such as assets owned by the contracting authority or other governmental agency), the concession would typically encompass both present and future assets of a tangible or intangible nature. Therefore, the lenders may regard the concession as an essential component of the security arrangements negotiated with the concessionaire. A pledge of the concession itself may have various practical advantages for the concessionaire and the lenders, in particular in legal systems that would not otherwise allow the creation of security over all of a company's assets, or which do not generally recognize non-possessory security interests (see chapter VII, "Governing law", __). These advantages may include: avoiding the need for creating separate security interests for each project asset, allowing the concessionaire to continue to deal with those assets in the ordinary course of business, making it possible to pledge certain assets without transferring actual possession of the assets to the creditors. Furthermore, a pledge of the concession may entitle the lenders, upon occurrence of default by the concessionaire, to avert termination of the project by taking over the concession and making arrangements for continuation of the project under another concessionaire. A pledge of the concession may, therefore, represent a useful complement to or, under certain circumstances, a substitute for a direct agreement between the lenders and the

contracting authority concerning the lenders' step-in rights (see chapter V, "Infrastructure development and operation", ___).

38. However, in some legal systems there may be obstacles to a pledge of the concession in the absence of express legislative authorization. Under various legal systems, security interests may only be created in respect of assets which can be freely transferable by the grantor of the security. Since the right to operate the infrastructure is in most cases not transferable without the consent of the contracting authority (see paras. 52-55), in some legal systems it may not be possible for the concessionaire to create security interests over the concession itself. Recent legislation in some civil law jurisdictions has removed that obstacle by creating a special category of security interest, sometimes referred to by expressions such as "*h[illegible]eca de concesión de obra pública*" or "*prenda de concesión de obra pública*" ("concession mortgage" or "pledge of public works concessions"), which generally provides the lenders with an enforceable security interest covering all of the rights granted to the concessionaire under the project agreement. However, in order to protect the public interest, the law requires the consent of the contracting authority for any measure by the lenders to enforce such right, under conditions to be provided in an agreement between the contracting authority and the lenders. A somewhat more limited solution has been achieved in some common law jurisdictions in which a distinction has been made between the non-transferable right to carry out a certain activity under a governmental licence (i.e. the "public rights" arising under the licence) and the right to claim proceeds received by the licencee (i.e. the latter's "private rights" under the licence).

39. For countries where it may not be legally possible to allow the creation of security interest over the concession itself, it may be useful for the law to expressly authorize the concessionaire to create security interests over the economic rights arising out of the concession or the proceeds therefrom. Those proceeds typically include the tariffs charged to the public for the use of the infrastructure (e.g. tolls on a toll road) or the price paid by the customers for the goods or services provided by the concessionaire (e.g. electricity charges). They may also include the revenue of ancillary concessions. Security of this type is a typical element of the financing arrangements negotiated with the lenders. It may further play an essential role for the issuance of bonds and other negotiable instruments by the concessionaire. Statutory provisions recognizing the concessionaire's authority to pledge the proceeds of infrastructure projects have been included in recent domestic legislation in various legal systems.

(c) Security over shares of the concessionaire

40. The establishment of security interests over the shares of the concessionaire raises, in principle, concerns similar to those raised by an assignment of the concession (see paras. 52-55). Where the concession may not be assigned or transferred without the consent of the contracting authority, the law sometimes prohibits the establishment of security over the shares of the concessionaire. It should be noted, however, that security over the shares of the concessionaire is commonly required by lenders in project finance transactions, and that general prohibitions on the establishment of such security may unnecessarily limit the concessionaire's ability to raise funding for the project. As with other forms of security, it might therefore be useful for the law to authorize the concessionaire's shareholders to create such security, subject to the contracting authority's prior approval where an approval would be required for the transfer of equity participation in the project company (see para. 62).

5. Organization of the concessionaire

41. Project agreements typically contain provisions on the legal status of the concessionaire and deal with the question whether the concessionaire has to be established as an independent legal entity or whether the project may be awarded collectively to a project consortium. Provisions on these matters are often contained in national legislation on privately financed infrastructure projects as well.

42. As understood in business practice, a consortium is a contractual arrangement whereby a group of enterprises undertakes to cooperate in carrying out a project without integrating into an independent legal entity. Consortia have been widely used in the construction industry for the development of large, capital-intensive projects requiring technical expertise in different fields. Consortia are commonly regarded as purely contractual arrangements which do not have a juridical personality of their own. However, there is no uniform legal regime governing consortia. They may fall under different contractual categories provided in national laws, and the legal status of consortia as well as the rights and obligations of their members vary in different legal systems.

43. Forming a project consortium may present some advantages, such as more flexibility in dealings among the consortium members. Avoiding double taxation may also be a reason for choosing not to establish an independent legal entity in the host country, in case there is no bilateral double taxation agreement between the host country and the country or countries where the foreign investors have their residence for taxation purposes. There might also be instances where the contracting authority would wish to retain the possibility of engaging consortia for infrastructure projects, depending on the scale and nature of the project, or with a view to holding all consortium members jointly liable for the entire project.

44. For those countries that wish to retain such possibility, the law might give the awarding authority the option to award the project to a consortium or to require that a separate legal entity be established by the selected project consortium, depending on the needs of the project. However, a number of issues would need to be addressed in the project agreement, and extensive negotiations and detailed provisions might be required to ensure coordination among members of the consortium, adequate liaison with the contracting authority, as well as clarifying the extent of responsibilities and liabilities of each of the members of the consortium for the execution of the project.2/

2/ A brief discussion of issues arising out of contracting construction works with a non-integrated group of enterprises is contained in the *UNCITRAL Construction Legal Guide* (chapter II, "Choice of Contracting Approach", paras. 9-16). Some of the issues mentioned therein might also apply, *mutatis mutandis*, to negotiations concerning privately financed infrastructure projects, including the following: how the difficulty of bringing a claim against consortium members from different countries, should a dispute arise, may be overcome; how the dispute-settlement clause may be formulated so as to enable any dispute between the contracting authority and several or all the members of the consortium to be settled in the same arbitral or judicial proceeding; how guarantees to be given by third parties as security for performance and quality guarantees to be given by members of the consortium are to be structured; what ancillary agreements may have to be entered into by

45. More common, however, is for the concessionaire to be established as an independent legal entity. From the perspective of the contracting authority, an independent legal entity facilitates coordination in the execution of the project and may provide a mechanism for protecting the interests of the project, which may not necessarily coincide with the individual interests of all of the consortium members. This aspect may be of particular importance where significant portions of the services or supplies required by the project are to be provided by members of the project consortium. Since a substantial part of the liabilities and obligations of the concessionaire, including long-term ones (project agreement, loan and security agreements, construction contracts), are usually agreed upon at an early stage, the project may benefit from being independently represented at the time those instruments are negotiated.

46. Entities who receive concessions for the provision of public services are often required to be established as domestic legal entities under the laws of the host country. Given the public interest in the concessionaire's activities, the contracting authority may wish that the concessionaire comply with national accounting and publicity provisions (e.g. publication of financial statements; publicity requirements concerning certain corporate acts). However, such a requirement emphasizes the need for the host country to have adequate company laws in place (see chapter VII, "Governing law", ___). The ease with which the concessionaire can be established, with due regard to reasonable requirements deemed to be of public interest, may help to avoid unnecessary delay in the implementation of the project.

47. The appropriate time for the establishment of the concessionaire is a matter to be considered in the light of the different interests involved in a typical project. Moved by the interest to start the implementation phase as soon as possible, some contracting authorities might be inclined to require that the concessionaire be established at the earliest possible stage. However, it should be borne in mind that firm and final commitments by the lenders and other capital providers typically may not be available prior to the final award of the concession, particularly where a separate legal entity is the envisaged vehicle for raising funds for the project, such as in a "project finance" transaction (see "Introduction and background information on privately financed infrastructure projects", paras. ___). Therefore, where the contracting authority requires the establishment of an independent legal entity by the members of the selected bidding consortium to carry out the project, it is generally advisable to require that the concessionaire be established within a reasonably short period after, but not before, the award of the project.

48. Another important issue in connection with the organization of the concessionaire concerns the equity investment required for the establishment of the concessionaire. The contracting authority has a legitimate interest in seeking an equity level that ensures a sound financial basis for the concessionaire and guarantees its capability to meet its obligations. The total investment needed as well as the ideal proportion of debt and equity capital vary from project to project so that it would normally be difficult to establish a fixed sum or percentage that would be adequate for all instances. Thus, it may be undesirable to provide a legislative requirement of a fixed sum as minimum capital

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the contracting authority; whether there are any mandatory rules of the law governing an agreement with a group of contractors.

for all companies carrying out infrastructure projects in the country. A more flexible approach might be to indicate the minimum capital required for the establishment of the concessionaire as an ideal percentage of the total project cost in the request for proposals. Where the contracting authority prefers to negotiate the amount or ratio of equity investment offered by the selected bidding consortium, the contracting authority might prefer to have the flexibility to arrive at an adequate minimum capital in the course of the selection process.

49. In addition to the question of minimum capital, national laws may contain provisions concerning the form under which the concessionaire has to be organized. Some laws specifically require that the concessionaire be incorporated as a certain type of company, while other laws make no provision on this subject. In cases where it is considered important to specify the form in which the concessionaire is to be established, it is desirable to bear in mind the interest of the consortium members in ensuring that their liability will be limited to the amount of their investment. In order to avoid a subsidiary liability for payment of the concessionaire's debts, its shareholders will normally prefer a corporate form in which their liability is limited to the value of their shares in the company's capital, such as a joint stock company. They would not be ready to carry out a project that would require them to assume unlimited liability for the concessionaire's debts.

50. Some laws contain provisions concerning the scope of activities of the concessionaire, requiring, for instance, that they be limited to the development and operation of a particular project. Such restrictions might serve the purpose of ensuring the transparency of the project's accounts and preserving the integrity of its assets, by segregating the assets, proceeds and liabilities of this project from those of other projects or other activities not related to the project. Also, such a requirement may facilitate the assessment of the performance of each project since deficits or profits could not be covered with, or set off against, debts or proceeds from other projects or activities.

51. The contracting authority might also wish to be assured that the statutes and by-laws of the concessionaire will adequately reflect the obligations assumed by the company in the project agreement. Therefore, project agreements sometimes provide that the entry into force of changes in the statutes and by-laws of the concessionaire is effective upon approval by the contracting authority. Where the contracting authority or another governmental agency participates in the concessionaire, provisions are sometimes made to the effect that certain decisions necessitate the positive vote of the contracting authority in the shareholders' or board's meeting. In any event, it is important to weigh the public interests represented through the Government against the need for affording the concessionaire the necessary flexibility for the conduct of its business. The daily management of the project would be impaired if even minor matters concerning the company's internal affairs routinely required prior governmental clearance. Furthermore, requirements of this type may increase the risk of improper pressure being exercised against the concessionaire. Where it is deemed necessary to require the contracting authority's approval to proposed amendments to the statutes and by-laws of the concessionaire it is advisable to limit such a requirement to those cases that concern provisions deemed to be of essential importance (e.g. amount of capital, classes of shares and their privileges, liquidation procedures) and which should be identified in the project agreement.

6. Assignment of the concession

52. Concessions are granted in view of the particular qualifications and reliability of the concessionaire and in most legal systems they are not freely transferable. Indeed, domestic laws often prohibit the assignment of the concession without the consent of the contracting authority. The purpose of these restrictions is typically to ensure the contracting authority's control over the qualifications of infrastructure operators or public service providers.

53. Some countries have found it useful to mention in the legislation the conditions under which an approval to the transfer of a concession prior to its expiry may be granted, such as, for example, acceptance by the new concessionaire of all obligations under the project agreement and evidence of the new concessionaire's technical and financial capability to provide the service. General legislative provisions of this type may be supplemented by specific provisions in the project agreement setting forth the scope of those restrictions, as well as the conditions under which the consent of the contracting authority may be granted. However, it should be noted that these restrictions typically apply to the voluntary transfer of its rights by the concessionaire; they do not preclude the compulsory transfer of the concession to an entity appointed by the lenders, pursuant to a direct agreement between them and the contracting authority, for the purpose of averting termination due to serious default by the concessionaire (see further chapter V, "Infrastructure development and operation", ___).

54. Another situation that may require legislative consideration concerns the transfer, to another entity, of the responsibility to carry out one particular project activity, rather than full assignment of the concession. In cases where the concessionaire is given the right to provide ancillary services, or where the concession involves multiple activities capable of being carried out separately, the concessionaire may wish to engage another entity to carry out some of those activities by way of a partial assignment of its rights under the project agreement. Such a partial assignment is referred to in some legal systems as a "subconcession". Where the concession itself is not transferable, there may be obstacles to a partial assignment without legislative authorization. Under normal circumstances, however, the contracting authority would have no compelling reason for excluding altogether the possibility of subconcessions, provided that it can be satisfied of the reliability and the qualifications of the subconcessionaire.

55. Another related issue concerns the method for selecting a subconcessionaire. Some countries have special rules governing the award of contracts by public service providers, and in some countries the law expressly requires the use of competitive selection procedures for the award of subconcessions. Rules of this type were often adopted at times where nearly all infrastructure was owned and operated by the State, with little or marginal private sector investment. Their purpose was to ensure economy, efficiency, integrity and transparency in the use of public funds. However, in the case of infrastructure projects implemented by privately owned entities, there may no longer be a compelling reason of public interest for prescribing to the concessionaire the procedure to be followed for the award of subconcessions.

7. Transferability of shares of the project company

56. The contracting authority may be concerned that the original members of the bidding consortium maintain their commitment to the project throughout its duration and that the effective control over the concessionaire will not be transferred to entities unknown to the contracting authority. Concessionaires are selected to carry out infrastructure projects at least partly on the basis of their experience and capabilities for that sort of project (see chapter III, "Selection of the concessionaire", ___). Contracting authorities are therefore concerned that, if the concessionaire's shareholders are entirely free to transfer their investment in a given project, there will be no assurance as to who will actually be delivering the relevant services.

57. Restrictions on the transferability of shares in companies providing public services have been introduced in some countries in order to address the contracting authority's legitimate concern about those companies' ability to deliver the relevant service at the agreed standards and conditions. From a legislative perspective, however, it is important to consider the possible disadvantages of imposing limitations on the transferability of investment in concessionaire companies and the adequacy of such limitations to ensure delivery of the services promised.

58. Contracting authorities may draw comfort from the experience that the selected bidding consortium demonstrated in the pre-selection phase, and from the performance guarantees provided by the parent organizations of the original consortium and its sub-contractors. In practice, however, the comfort that may result from the apparent expertise of the shareholders in the concessionaire should not be overemphasized. Where a separate legal entity is established to carry out the project, which is often the case (see paras. 41-51), the backing of the concessionaire's shareholders, should the project run into difficulties, may be limited to their minimum liability. Thus, restrictions on the transferability of investment, in and of themselves, may not represent sufficient protection against the risk of performance failure by the concessionaire. In particular, these restrictions are not a substitute for appropriate contractual remedies under the project agreement, such as monitoring of the level of service provided (see chapter V, "Infrastructure development and operation", ___), termination without full compensation in case of unsatisfactory performance (see chapter VI, "End of project term, extension and termination", ___), or for the substitution of the project company by another concessionaire appointed by the lenders under a direct agreement with the contracting authority (see chapter V, "Infrastructure development and operation", ___).

59. It should also be noted that, to a certain extent, concerns about the concessionaire's ability to perform satisfactorily under the project agreement are not unique to the contracting authority. The partners of the concessionaire, including the lenders, will be as concerned as the contracting authority to ensure that the designer, the construction contractor and the operating company meet their obligations under the project agreement. In practice, contractual guarantees, performance bonds or insurance policies (see chapter V, "Infrastructure development and operation", ___) may be more effective in protecting against future non-performance than the forced retention of investment by a defaulting partner.

60. In addition to the above, restrictions on the transferability of shares in companies providing public services may also present some disadvantages for the contracting authority. Limitations on the private sector's freedom to the transfer of its equity participation in privately financed infrastructure projects may also limit the variety of investment types and investors, thus reducing the chances of lowering the cost of funding. From a long-term perspective, the development of a market place for investment in public infrastructure may be hindered if investors are unnecessarily constrained in the freedom to transfer their interest in privately financed infrastructure projects.

61. As noted earlier (see "Introduction and background information on privately financed infrastructure projects", ___), there are numerous types of funding available from different investors for different risk and reward profiles. The initial investors, such as construction companies and equipment suppliers, will seek to be rewarded for the higher risks which they take on, while subsequent investors may require a lesser return commensurate with the reduced risks they bear. Most of the initial investors have finite resources and need to recycle capital in order to be able to participate in new projects. Therefore, those investors would typically avoid tying up capital in long term projects. At the end of the construction period, the initial investors might prefer to sell their interest on to a secondary equity provider whose required rate of return is less. Once usage is more certain, another refinancing could take place. However, if the investors' ability to invest and re-invest capital for project development is restricted by constraints on the transferability of shares in infrastructure projects, there is a risk of a higher cost of funding. In some circumstances it may not be possible to fund a project at all, as some investors whose involvement may be crucial for the implementation of the project might not be willing to participate.

62. For the above reasons, it may be advisable to limit the restrictions on the transfer of shares of concessionaire companies to situations where such restrictions are justified by compelling reasons of public interest. One such situation may be where the contracting authority or other agency of the Government has entrusted a concessionaire with public assets (see para. 23), or where the concessionaire receives loans, subsidies, equity or other forms of direct governmental support (see chapter II, "Project risks and Government support", ___). In these cases, the contracting authority's accountability for the proper use of public funds requires assurances that the funds and assets are entrusted to a solid company, to which the original investors remain committed during a reasonable period. Another situation which may justify imposing limitations on the transfer of shares of concessionaire companies may be where the contracting authority has an interest in preventing transfer of shares to particular investors. For example, the contracting authority may wish to control acquisition of controlling shares of public service providers to avoid the formation of oligopolies or monopolies in liberalized sectors (see "Introduction and background information on privately financed infrastructure projects", ___). Or it might not be thought appropriate for a company that had defrauded one part of Government to be employed by another through a newly acquired subsidiary.

63. In these exceptional cases it may be advisable to require that the initial investors seek the prior consent of the contracting authority before transferring their equity participation. It should be made clear in the project agreement that any such consent should not be unreasonably withheld or unduly delayed. For transparency purposes, it may be further advisable to set forth in the law the grounds under which approval may be withdrawn and to require the contracting authority to specify in each

instance the reasons for any refusal. The appropriate duration of such limitations (e.g. whether for a particular phase of the project or for the entire concession term) may need to be considered on a case-by-case basis. In some projects, it may be possible to relax such restrictions after the facility has been completed. It is also advisable to clarify in the project agreement whether these limitations, if any, should apply to the transfer of any participation in the concessionaire, or whether the concerns of the contracting authority will focus on one particular investor (e.g. a construction company or the facility designer) while the construction phase lasts, or for a significant time beyond.

8. Duration of the project agreement

64. The laws of some countries contain provisions that limit the duration of infrastructure concessions to a certain number of years. Some laws establish a general limit for most infrastructure projects, and special limits for projects in particular infrastructure sectors. In some countries there are maximum duration periods only for certain infrastructure sectors.

65. The desirable duration of a project agreement may depend on a number of factors, such as: the operational life of the facility; the period during which the service is likely to be required; the expected useful life of the assets associated with the project; how changeable is the technology required for the project; the time needed for the concessionaire to repay its debts and amortize the initial investment. Given the difficulty of establishing a single statutory limit for the duration of infrastructure projects, it is advisable to consider adopting statutory solutions that afford the contracting authority some flexibility to negotiate, in each case, a term that is appropriate to the project in question.

66. In some legal systems, this result is achieved by provisions which require that all concessions should be subject to a maximum duration period, without specifying any number of years. Sometimes the law only indicates which elements are to be taken into account for determining the duration of the concession (e.g. nature and amount of investment required to be made by the concessionaire, the normal amortization period for the particular facilities and installations concerned). Some project or sector-specific laws provide for a combined system requiring that the project agreement should provide for the expiry of the concession at the end of a certain period, or once the debts of the concessionaire have been fully repaid and a certain revenue, production or usage level has been achieved, whichever is the earliest.

67. However, where it is found necessary to adopt statutory limits, the maximum period should be sufficiently long to allow the concessionaire to fully repay its debts and to achieve a reasonable profit. Furthermore, it may be useful to authorize the contracting authority, in exceptional cases, to agree to longer concession periods, taking into account the amount of the investment and the required recovering period, and subject to special approval procedures.

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